

Comments submitted to The National Commission to Ensure Consumer Information and Choice in the Airline Industry

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Thank you for providing me with the opportunity to submit comments to the Commission. PPI is a non-partisan think tank whose mission is to modernize progressive politics and government for the Information Age. As relates to the Commission's charge -- the financial condition of travel agents -- PPI has been focused extensively on identifying and advancing policies to further e-commerce and digital transformation, including accelerating the movement toward online travel distribution. In this regard we believe that the Commission should not recommend that Congress or the Administration take steps to restrict Internet access to travel. For your information I have attached a copy of a recent PPI report that address this and other related issues, *The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers*.

In the past travelers wishing to purchase an airline ticket had to either call the airline or contact their travel agent. In this environment travel agents often provided consumers with valuable information that let them find the lowest fares. However, with the rise of the Internet and travel web sites such as Expedia, Travelocity and Orbitz, consumers now have access to information as good if not better than travel agents have. Given this new parity there is no inherent reason why travel agents are needed to protect consumers. As long as Internet sources of information on fares exist this should not change.

In fact, by raising transaction costs, travel agents actually add to the costs consumers bear. Travel agents have long opposed the kinds of commission reductions that airlines have finally been able to impose. But from an economic efficiency perspective it's clear that commissions paid for by the airlines distort the marketplace and lead consumers to use the high cost channel to buy tickets, thereby lowering overall economic efficiency and

raising costs. If consumers can get the same ticket from both a travel agent and the Internet for the same price, they have significantly less incentive to use the more efficient channel - the web. After all, why should consumers who choose the low-cost, self serve model indirectly subsidize someone who uses a travel agent. By eliminating commissions airlines are creating a level playing field that lets consumers decide: if they want more personalized service from an agent they can pay a little extra for it; if they want self-service on the web they can do it without paying a service fee surcharge (or a smaller surcharge).

This issue of pricing distribution services to reflect their true cost to encourage consumers to use the low cost channel is central to the current controversy over Internet-only fares. There has been considerable controversy over the practice of airlines restricting certain low cost fares to the Web, and considerable pressure put on Congress and regulators to require airlines to make web fares available to all. For example, The Airline Passenger Bill of Rights Act of 2001 appears to prohibit airlines from issuing web fares, unless they were also available to all channels, including bricks and mortar travel agents. But as PPI stated in its report *The Revenge of the Distintermediated*:, "Airlines should be allowed to provide their lowest fares to sites like Orbitz because dealing with them does not cost the airlines as much money as dealing with a travel agent." The whole point of web fares is to encourage consumers to use the Internet to book tickets because this is the low cost channel. If the point of economic policy is to keep productivity from rising, then requiring by law that travel agents have unfair incentives is a good way to get there.

The second key question is whether travel agents are at risk in the marketplace. Clearly as Internet self-service increases for reasons of cost and convenience, the market share of travel agents will continue to shrink. But just as some people shop at stores like Nordstroms to get high quality, personalized service there will always be some people who use travel agents. The key question is whether protectionist barriers (such as requiring travel agents to gain access to web fares while still getting paid commissions) will be erected or whether consumers will decide what share of transactions are done through self-service and which are done with agents. We believe that the marketplace and consumers should decide that outcome. In fact, with all due respect, I would submit that the very charge of the Commission to study "the competitive condition of smaller travel agencies" has little to do with the welfare of consumers or boosting productivity in the travel distribution industry. Yet, many travel agents have attempted to portray this fight as one between

small business and big corporations. For example, the American Society of Travel Agents recently applauded 23 congressmen for sending a letter to the Deputy Assistant Attorney General that asked DOJ to "intensify its ongoing investigation of Orbitz" for "taking such a pro-small business stance." But the real issue is not whether big business is winning against small business, its whether travel intermediaries will be able to erect rules that will let them maintain market share.

In fact, the financial condition of distributors of products in general has little impact on consumers. While producers of any product or service, including airlines, have a number of incentives to collude to extract what economists call monopoly rents from consumers in the production process, they have much less incentive or ability to do so in the distribution process.

There may be real issues with regard to airline market power in particular hubs, for example, but the industry has a vested interest in driving down the costs of distributing their product.

After all, they want to cut costs out of airline travel so that consumers will fly more. Far from being a nefarious plot by the industry to control the distribution channel, as some in the travel distribution industry have argued, the move to cut commissions was stimulated by trying to cut costs of distribution by encouraging consumers to use lower cost distribution channels.

This was in fact the main motivation behind the airlines' decision to back the creation of Orbitz, an online travel distribution service. Because seed money for Orbitz came from the five largest American carriers—United, Delta, Northwest, Continental, and American—its online and off-line opponents claim that Orbitz will gain market share unfairly. They argue that because airlines will provide Orbitz with special last-minute, cheaper fares and exclusive access to preferred fares, the kind they also offer on their own Web sites, Orbitz will obtain an unfair competitive edge.

There are two arguments that are being made: first, that Orbitz will somehow enable collusive behavior in the production of travel services, and second, that Orbitz will itself gain monopoly power in travel distribution. With regard to the first point, there is little evidence that Orbitz would enable fare price collusion. After all, all the fares are already out in the open on the individual airline web sites. Besides, as the federal government has done in the past with regard to the Airline Tariff Publishing Company when it took action to prevent information sharing, it's highly likely that government would quickly step in to punish and prevent in the future any collusive behavior based on information sharing.

The second point regarding Orbitz' possible market power in travel distribution is just as groundless. First, less than 2 percent of all airline tickets are sold through Orbitz, suggesting that they have no market power. But even if Orbitz were to gain a dominant market share, this in and of itself would not be cause for concern precisely because the airlines exert majority control over it. Their interest is in having a low cost distribution channel, not a high cost one. But for the sake of argument assume that Orbitz wanted to charge consumers a high transaction fee that the airlines would keep as profit. Two things would happen: most people would use Orbitz only as a search engine and would book tickets directly on the airline web site to avoid the fee, and other online companies charging lower fees would take market share away from Orbitz.

In summary, we find no evidence that there is a problem at hand that deserves government involvement at this time. The marketplace appears to be working exactly as it should: developing new innovations to give consumers more choice while increasing economic efficiency. We would hope that as the Commission considers these issues that you would focus first and foremost on travel consumers and not on preserving the existing market share of the travel distribution industry.

Respectfully,

Robert Atkinson